Money Management

- When we make money decisions, they have consequences that ripple through our life
- The limbic system in our brain is responsible for things like emotions, automatic responses to stimuli, and memory
- If you can control your myopic and loss=aversion tendencies, you can achieve a long-term bonus by accepting investment risk
- More important than knowledge is the ability to use that knowledge to change habits
- We all have a tendency to sell our winning stocks and keep our losing stocks
- Life cycle theory
    - You should spend your money when it gives you the most happiness and save it in times of plenty
    - We get a little less happiness for each additional dollar we spend
    - Borrowing means you spend less in the future in order to spend more money today
    - Saving means you spend less today so you can spend more in the future
    - According to life cycle finance, you're doing it right if the amount of happiness you get from spending in all of your life cycle periods (young, middle age, retired) is the same
    - You should be both a borrower and a lender
    - You should be a borrower when you're young and investing in education and you should be a lender when you're in the peak earning years of middle age
    - The younger you start saving the more wealthy you'll be later in life
    - In general, people who have more money do appear to be happier
    - Life is a game where the goal is to get the most out of life with the money you have
    - More education means a steeper earnings path
    - You should save a larger percentage of your salary as your income rises
    - Investing is anything that reduces or spending now in order to increase spending in the future
    - Getting an education is an investment because we spend time and money in the present in order to increase our earnings in the future

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    - Risk means the possibility of loss
- A liquid asset can be turned quickly into cash
- You have a checking account so that you can write a check and immediately turn your financial asset into cash
- Liquid assets are good because they can provide immediate resources to cover a health emergency, spending during a period of unemployment, or payment for an unexpected home repair
- Liquid assets are very safe
    - Safe assets have a lower rate of return than risky assets
    - One cost of keeping money in your checking account is that it won't grow in value over time from taking investment risk
- Investments that are easier for cash will have a lower rate of return
- A Certificate of Deposit (CD) is less liquid than a checking account, but with a higher rate of return than a checking account
- Risk is when we don't know what the payout will be, and greater volatility in the payout means higher risk
- A risk-tolerant investor is willing to accept a 50/50 chance of spending less or spending more
- One of the best strategies for building wealth is being able to accept an occasional loss when taking a risk makes sense
- In general, you want to hold a mix of assets in your portfolio that is well-diversified
- Individual stocks tend to be very volatile
- No amount of diversification is going to get rid of risk in the overall market
- Investors get rewarded with a higher expected return for taking more systematic risk, and they get no extra return for bearing unsystematic risk
- The most diversified portfolio you can get in a portfolio that invests in every type of risky asset
- Cash is considered the most liquid asset
- Checking accounts allow unlimited monthly transactions. If they are drawn from a bank that is a member of the Federal Deposit Insurance Corporation (FDIC), they are also protected for up to $250,000
- Mutual funds invest in securities like stocks and bonds

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- The best way to invest in stocks and bonds is through passive, well-diversified, low-expense-ratio exchange-traded funds and mutual funds
- Why do you think there are so many mutual funds if most investors would be better off investing in a low-fee index fund?
- Credit gives us spending flexibility and convenience
- Credit cards are issued by a bank
- The bank makes money from charging you interest in the outstanding balances of your credit card debt, fees for things like late payments, and an interchange fee
    - The interchange fee is paid to the bank by the merchant
- It's certainly easy to swipe a credit card to buy goods, but you can get into credit card debt if you aren't good at managing your money
- Debit cards draw money immediately out of your bank account
- The most significant sources of consumer debt are student loans and mortgages
- Education pays off in the long run, but you have to figure out how to pay for it first
- Education payout will be higher from an investment in a major that requires more specialized skills in a field where workers are in high demand
- Planning for an education requires estimating future costs including tuition, books, suppliers, and living expenses
- The government provides a number of tax incentives to encourage people to save for education. The most common is the 529 plan. Any money you invest can be taken out tax-free if you use it for qualified educational expenses such as college tuition, fees, dorms, and other school expenses
- You cannot deduct the investment in a 529 from your taxable income
- The Economics of Home Ownership
    - A home is our largest asset and a mortgage is our most significant liability
    - If you are going to live in a location for at least five or six years, then consider buying a home
    - Higher income and lower debt means you'll qualify for a bigger loan
    - When buying a house, you need enough money for a down payment, which should be at least 20% of the price of the house
    - The APR contains all the information about the financing costs of the loan
    - Think of the costs of renting versus ownership when you buy a house